United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2142

DOCKET NO. 74-2142

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

In the Matter of

JERCYN DRESS SHOP, a Partnership,
and JACK A. SCHERER and EVA SCHERER,
as general partners, jointly.

Alleged Bankrupts.

On Appeal from the United States District Court

for the Eastern District of New York

APPELLANT'S BRIEF

ROBERT P. HERZOG
Attorney for Appellants
185 Madison Avenue
New York, New York 10016
(212) 725-0001

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES AND RULES

MISCELLANEOUS

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

----------x

In the Matter

of

JERCYN DRESS SHOP, a partnership,
and JACK A. SCHERER and EVA SCHERER, 74-2142
as general partners, jointly,

Alleged bankrupts.

----------x

This brief is submitted on behalf of the Appellants, seeking disaffirmance of an order of the District Court affirming an order of the Bankruptcy Judge dismissing an involuntary petition filed jointly against the individual partners of a partnership adjudicated bankrupt.

PRELIMINARY STATEMENT

On October 19, 1972, Jack A. Scherer and Eva Scherer, as the two general partners of Jercyn Dress Shop ("Jercyn") made a general assignment for the benefit of creditors of Jercyn, which was duly filed with the clerk of the Supreme Court of the County of Kings.

On November 15, 1972, an involuntary petition in bankruptcy was filed against Jercyn and against each of its general partners, jointly, alleging as the sole act of bankruptcy the making and filing of the aforesaid assignment for the benefit of creditors of Jercyn. Jercyn consented to its adjudication in writing on December 6, 1972, but its formal adjudication, as such, was held in abeyance pending decision by the Bankruptcy Judge of a motion made by the two individual partners, the Scherers, to dismiss the petition against them. They contended in their motion that no act of bankruptcy had been alleged in the involuntary petition as against them, as individuals.

The Bankruptcy Judge, for the reasons set forth in his opinion below, dated April 3, 1973, granted the application of the individual alleged bankrupts, concluding that the making of the assignment for the benefit of creditors was a partnership act of bankruptcy and did not constitute an act of

bankruptcy by the individuals as well, which holding was affirmed on review to the District Court.

The appellants seek further review of the decision of the Bankruptcy Judge, as affirmed by the District Court and so much of the order entered thereon, dated April 5, 1973, which dismisses the involuntary petition against Jack A. Scherer and Eva Scherer, individually.

THE QUESTION PRESENTED

The sole question presented on this appeal is whether the assignment for the benefit of creditors executed by the Scherers, as co-partners of Jercyn, constituted acts of bankruptcy of the individuals as well.

ARGUMENT

AN ASSIGNMENT OF PARTNERSHIP PROPERTY FOR THE BENEFIT OF CREDITORS IS AN ACT OF BANKRUPTCY NOT ONLY BY THE PARTNERSHIP BUT ALSO BY THE INDIVIDUAL PARTNERS MAKING THE ASSIGNMENT

Because of the unique status of a partnership and the interrelations between a partner's

liability to both his individual creditors and the partnership creditors, a general assignment for the benefit of creditors of a partner's partnership interest must also be an individual act of bankruptcy. A look at the various provisions of the Partnership Acts and the effect that they have on the creditors of both the partners and the partnership will illustrate why this must be so, and why the Bankruptcy Act cognizant of these provisions provides for joint adjudication and administration of both the partners and the partnership where necessary.

It must be assumed that prior to credit being extended, a debtor's assets are considered by the future creditors, who make a determination that such assets are sufficient to insure that the debt will be repaid. The creditors when they extend credit are fully aware of the fact that they have the right to rely on two distinct and valuable assets of a partner -- his individual assets and

his partnership interest.

While the individual creditors of a partner cannot levy and execute on the partnership property itself, a judgment creditor of a partner can get control of his partnership interest. Under New York Partnership Law Sec. 54, a judgment creditor of a partner can get a charging order charging the interest of the debtor partner with payment of the unsatisfied amount of such judgment debt with interest thereon. The judgment creditor is entitled to any profits which would come due to the debtor-partner's interest, or he can have the debtor-partner's interest sold to another, if necessary, to satisfy his judgment. Under New York Partnership Law Sec. 53, a conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, "...but it merely entitles the assignee to receive, in accordance with his contract, the profits to which the assigning partner would otherwise be entitled."

Under these two sections, the individual creditors are entitled to rely on any future profits which the partner may get in order to satisfy any debts which the partner might incur with them. But if the partnership, by an act of the partners is allowed to assign all its partnership interest to another, then the partner's individual creditors would be cut off from recourse to his partnership interest to satisfy the debts he owes them should his individual assets be insufficient.

Sec. 62 of the New York Partnership Law holds that a general assignment cannot be executed by a partnership unless authorized by all of the partners. Once the assignment is made, however, it is an act of bankruptcy and the partnership creditors can, as was in the instant case, institute involuntary proceedings to adjudicate the partnership bankrupt, and the partnership will be dissolved. The adjudication of the partnership, as a bankrupt, would completely frustrate the purpose of the charging order and the purpose of Sec. 53 which is to enable a partnership

to continue even though an individual partner's interest in the partnership was assigned to his individual creditors.

To allow the partners to assign their partnership interest to another for the benefit of the partnership creditors, without giving the individual creditors recourse to an involuntary petition in bankruptcy against the partners making the assignment, would amount to a fraud on his individual creditors who have relied on the partner's partnership interest as a source of assets. In many small partnership firms, the sole assets and income of the partner is derived from the partnership business. Thus, if a partner made an assignment for the benefit of firm creditors, such an act must be construed not only a partnership act, but also an individual act, because he is assigning to another the only valuable asset he has. Or you could have the reverse situation, where the partnership assets are meager and insufficient to satisfy such creditors, thereby forcing the

partnership creditors to take such individual assets as may be left after satisfying their individual, post-assignment creditors.

To hold that a general assignment for the benefit of a partnership, which is admittedly the fourth act of bankruptcy as regards the partnership, is not also an individual act of bankruptcy, is to give the assigning partner the right to choose which creditors, either individual or partnership, he wants preferred for payment, and which creditors he can cut off.

The purpose of the Bankruptcy Act is to insure an equitable distribution of a bankrupt's assets among all his creditors, and to give the honest debtor a chance to be financially rehabilitated, free of prior debts. To ratify the position which the courts below have held, namely, that the act alleged is only a partnership act of bankruptcy, is to pervert the reason for and meaning of a partner's assets.

The inequitable consequences of the holding of the courts below on partnership creditors is easily illustrated. To permit the assignment for the benefit of partnership creditors to be construed only as a partnership act of bankruptcy, and not also an individual act of bankruptcy, allows the individual partners, if they chose, to squander their individual assets before the partnership creditors could share in them. The individual partners will have been thereby afforded an opportunity to dissipate their individual assets, forcing the partnership creditors to abide the partner's subsequent individual commission of an act of bankruptcy, with the resultant right to share in such individual assets, if any, that might remain.

By holding that the assignment is both a partnership and an individual act of bankruptcy, the date has been fixed which will be used for marshaling the assets of both the partnership and the partners. It prevents a partner from utilizing his personal assets preferentially and to the detriment of his partnership creditors.

The Bankruptcy Act envisioned this, within its scheme. Sec. 5g of the Bankruptcy Act provides that should any surplus remain of the property of any general partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of partnership debts. Sec. 5j provides that the discharge of a partnership in bankruptcy shall not discharge the individual general partners thereof from the partnership debts. Sec. 5j, by not discharging the general partners from the partnership debts, in effect makes the partnership creditors also individual creditors of the partners, at least insofar as the partnership assets are insufficient to pay off the partnership creditors. So by making the assignment for the benefit of partnership creditors also an individual act of bankruptcy, the partnership creditors are afforded protection from a dishonest debtor-partner by allowing them in the joint adjudication to examine the individual partner to make sure that the partner has not attempted to secrete individual assets which

would be used, if surplus, to pay off the partnership debts.

Thus Sec. 5j permits a partner adjudged a bankrupt in a separate or joint proceeding to be discharged from both his partnership and his individual debts.

What the Bankruptcy Act intended, and what all the prior cases have held, is that the making of the general assignment for the benefit of partnership creditors is also an individual act of bankruptcy which enables both the individual and partnership creditors to file an involuntary petition, and thereby be assured that they would be paid from the assets which existed at the time of the assignment.

This is the only holding possible in light of the purpose of the Act, namely, the equitable distribution of a debtor's assets. To hold otherwise is to discriminate against some creditors of a partner, and put them in a position far inferior to that of other creditors, without giving them any recourse for relief. The Bankruptcy Act intended an equitable

distribution of assets to all creditors. It did not and does not condone a result whereby the creditors are not treated equitably.

The spirit of Section 5 of the Bankruptcy Act is to enable both the partnership and the partners to be adjudicated together when necessary to ensure an equitable distribution of the assets. The Act is replete with sections which recognize the necessity in some cases of joint adjudication and administration to accomplish this purpose.

Sec. 5(a) provides that a partnership may be adjudged a bankrupt either separately or jointly with one or more or all of its general partners.

Sec. 5(b) provides that a petition may be filed by one or more of the general partners in the separate behalf of a partnership or jointly in behalf of a partnership and of the general partner or partners filing the same.

Sec. 5(c) provides that the creditors of the bankrupt partnership shall appoint the trustee, who shall also be the trustee of a general partner

being administered in the proceeding unless the creditors of a general partner object for cause.

Sec. 5(d) provides that the court of bankruptcy which has jurisdiction of one of the general partners shall have jurisdiction of all the general partners and of the administration of the partnership and individual property.

Sec. 5(f) provides that the expenses shall be paid from the partnership property and the individual property in such proportions as the court shall determine.

Sec. 5(h) provides that the court may marshal the assets of the partnership estate and individual estates so as to prevent preferences and secure the equitable distribution of the property of the several estates. (emphasis added)

From the preceding sections, it is obvious that the Act envisions and provides for joint adjudication where necessary. But this does not mean that there must be a joint adjudication, as was Bankruptcy Judge Price's contention in the decision below. Relying on that interpretation, Judge Price dismissed

the involuntary petition against the individual bankrupts. The Judge reaches this conclusion on the last page of his opinion, stating:

> In the case at bar, the assignment for the benefit of creditor relied on by the petitioning creditors as an act of bankruptcy was executed by the partnership, Jercyn Dress Shop, as an entity and not by the Scherers as individuals. This partnership act could not be imputed ipso facto to them and thus be used as an act of bankruptcy against them. To accept the contention of the petitioning creditors would mean that the partnership entity could never be separated from the individual partners in bankruptcy proceedings since the partnership could only commit an act of bankruptcy through one of its partners. This flies in the fact of the clear language of Section 5(a) and (b), which specifically provides for the adjudication of the partnership alone, independent of the adjudication of any partner.

But, it does not follow that simply because the act of assignment is an act of bankruptcy for both the partnership and the individuals joining in it, proceedings solely for the partnership could not occur. It is perfectly permissible for the partnership to file a voluntary petition without joining any partner (Sec. 5(b)). Also, petitioning creditors

of t' partnership might choose to proceed only against the partnership (Sec. 5(a)). If the assignment for the benefit of partnership creditors was made while the partnership was solvent, the petitioning creditors might proceed only against the partnership because they know they will be paid in full from the partnership assets. And if the individual creditors of a partner are satisfied that he still has plentiful assets and that they are not harmed by the assignment, they could well decide not to file a petition against the individual partner.

The reason that a general assignment for the benefit of partnership creditors is an individual act of bankruptcy is to give the creditors this choice. The individual creditors of a partner who has a multitude of other valuable assets are not going to force him into bankruptcy, because he assigned one of his many assets. But it is necessary to give the creditors this option because there will be times when the only valuable asset of a partner will be

his partnership interest. And then the individual creditors will be forced to initiate bankruptcy proceedings against the individual partner to ensure that they as well as the partnership creditors get their equitable share of the distribution of the assets which existed at the time the general assignment was made. And there will be times when a dishonest debtor makes the assignment in order to prefer his individual creditors or in order to secrete individual assets from his partnership creditors. This also protects the partnership creditors because by forcing a joint adjudication they will find out what assets the partner has as of the date of the assignment, and will be able through examination of the partner to assure themselves that he is not trying to secrete assets which would go toward paying the partnership debts after his individual debts are paid off.

Thus the entity theory of partnerships which allows for the adjudication of the partnership alone as an entity, independent of the adjudication

of any partner is left intact, and is in no way disturbed or altered by the position which we urge, and which all the prior cases on this point have held. As illustrated above, there is no conflict between Section 5(a), which permits separate proceedings, and the cases holding that an assignment is an act of bankruptcy for both the partnership and the partners making it. Chemical National Bank v. Meyer, 92 F. 896, aff'd., 98 F. 976 (2 Cir. 1899); Green River Deposit Bank v. Craig Bros., 100 F. 137 (W.D.ky. 1901); cf. Holmes v. Baker and Hamilton 160 F. 922 (9 Cir.).

The Meyer and Green River cases hold that an assignment by a partner of the partnership assets is as act of bankruptcy by the partnership and of the individual partners executing the assignment.

In Meyer, one of the partners, Dickinson, did not join in the assignment, and was not adjudicated. He was held to have authorized Meyer, the assigning partner, by appointing him liquidating partner.

In the Holmes case, the individual partners, as a result of their passiveness, were adjudicated bankrupt solely for failure to discharge an execution levied after the dissolution of the partnership.

These cases illustrate acts of bankruptcy which plunge not only the firm but the individual partners into bankruptcy.

The acts of bankruptcy by a partnership are discussed in Collier on Bankruptcy, 14th Ed. ¶5.05, which states:

> " In order for a partnership to be the the subject of an involuntary adjudication the petition must allege an act of bankruptcy on the part of the firm. The general rule that whatever a partner does within the scope of the partnership binds the other partners, applies to the commission of acts of bankruptcy. Generally speaking, the commission of an act of bankruptcy as to the partnership property by one partner amounts to an act of bankruptcy by the firm. A concealment of firm property by one partner with intent to hirder, delay or defraud firm creditors is a firm act of bankruptcy, at least where it may be found that the other partners acquiesced. An admission made by one partner of inability on the part of the firm to pay debts and its willingness to be adjudged bankrupt is the sixth act of bankruptcy and is committed by the firm if the other partners have consented thereto, or if such consent can be presumed.

> On the other hand if the act complained of has not been for or on behalf of the firm and in respect of firm assets, it will not sustain a petition against the firm as such. Thus, if one partner embezzles funds of the firm, this does not constitute a firm act of bankruptcy. And if a partner makes a conveyance of his individual assets to a firm creditor, even with intent to prefer that creditor, this is not an act of bankruptcy by the firm. Although it has been held that an assignment of the firm property for the benefit of creditors, made by one partner without the consent of his co-partner, is a firm act of bankruptcy, this proposition is of questionable validity, since one partner probably does not have authority to make such an assignment. But, if a general assignment is made by a partnership and each of the members thereof, it is an act of bankruptcy by the firm and the members individually, and where such an assignment is made the partnership should be adjudged bankrupt irrespective of the question of solvency.
>
> The appointment of a receiver for an insolvent partnership is an act of bankruptcy. The failure to discharge an execution levied after the dissolution of the partnership is an act of bankruptcy for which the firm and all the partners may be adjudged bankrupt. " (Citing Holmes v. Baker & Hamilton, 160 F. 922).

Thus it is seen that partnership acts, and even inaction, by partners with respect to partnership property can constitute acts of bankruptcy of the individuals as well.

And Meyer directly and affirmatively answered the question "(1) Was such an assignment of the firm property by Meyer an act of bankruptcy by him individually?"

This Court of Appeals, in affirming the Meyer case, stated:

> "As the assignment purported to transfer all the property of the partnership, it was a general assignment by the partnership, though, as it purported to transfer only their joint, and not their individual, property, it was but a partial assignment by the individual partners. Whether having been made by one partner only, it was valid, void, or voidable is immaterial. Apparently the partner who did not join has ratified, by acquiescence, the act of the partner who executed it. However this may be, in denominating the making of a general assignment for the benefit of creditors an act of bankruptcy, congress did not make any distinction between valid or invalid instruments, but used terms which would reach the execution of any instrument which is, or purports to be, a general assignment. The majority of the court are of the opinion that the making of the assignment by Meyer, being an act of bankruptcy of which he was the author, entitled the creditors to an adjudication against him individually." In re Meyer, et al., 98 F. 976, 980 (C.C.A. 2d. Cir., 1899) (Emphasis Added)

In a similar case decided under Section 5, another Court of Appeals stated:

"It is true that an individual member of a firm cannot be adjudged a bankrupt for an act of bankruptcy nc committed by him or in which he did not participate (In re Meyer, 98 Fed. 976, 39 C.C.A. 368); but that is not the case here presented. The act of bankruptcy in this case was committed by all the members of the firm. It was an act of omission, the failure to discharge the levy of the execution, a duty which rested as much upon the appellant as upon any member of the firm. Notwithstanding the dissolution of the co-partnership, it remained, as it was before, the appellant's duty to see that the property of the co-partnership was devoted to the payment of the partnership debts, as to which he had not been released." Holmes v. Baker and Hamilton, et al., 160 F. 922, 923 (C.C.A. 9th Cir. 1908).

In In re Grant, et al., the District Court of the Southern District of New York held, that where one partner executed an assignment of partnership property for the benefit of creditors, this constituted an individual act of bankruptcy not only for that partner, but also for his co-partner who had only orally advised that the assignment be made but had not personally executed the assignment. In that case, the partnership and the individual partners were adjudged bankrupts. (In re Grant, et al., 106 F.496 (S.D.N.Y. 1901).

See also, In re Kersten, et al., 119 F.929 (Vt., 1901) 1 Remington on Partnerships, 5th Ed., 1950, 386 (p. 153); 11 U.S.C.A. Sec. 23(a), Note 10 (Citing Authorities,

The appellees rely on the case of Liberty National Bank v. Bear 276 U.S. 215 (1928). But Liberty is clearly distinguishable from the present case. In Liberty the involuntary petition did not seek an adjudication of the individuals, as was the case in Meyer and in the present case. In Liberty, the individuals filed a separate petition, voluntarily, hence the Court did not have to find an individual act nor rule on whether an assignment of partnership property constituted an individual act as well, as did the Court in Meyer. Liberty, as the court below noted, distinguishes between individual and partnership acts by a partner. Some acts by a partner are only individual acts, or only partnership acts and individual acts of bankruptcy, as can be seen from both the Meyer and the Holmes cases. Liberty does not hold, that an act of bankruptcy, the assignment for the benefit of partnership creditors, is not an act

of bankruptcy for both the partnership and the individual partners making it.

Judge Neaher in his opinion below quoted an authority on bankruptcy with whom he agreed.

> "(t)here can be no serious question but that, to throw an individual partner into bankruptcy, as contrasted with accomplishing this result as to the firm, a partnership act will not suffice; the act must be his individual act as well or he must have committed some other individual act of bankruptcy." 1 H. Remington on Bankruptcy Sec. 86 at 154 (1950) (Emphasis Added).

We also agree with Mr. Remington and submit that the making of an assignment for the benefit of partnership creditors is not only a partnership act of bankruptcy but as well constitutes an individual act of bankruptcy of the assigning partner or partners.

CONCLUSION

For the reasons set forth above, the court should find as a matter of law, that the assignment of the partnership property executed by both partners constituted an act of bankruptcy, both as to the partnership property so assigned and as to the

individual who so acted; that the alleged bankrupts' motion should have been in all respects denied and their answer dismissed; that the courts below were in error in dismissing the involuntary petition against them; and that the alleged bankrupts be adjudicated bankrupts and that the bankruptcy be proceeded with.

Dated: New York, N. Y.

November 8, 1974

Respectfully submitted,

ROBERT P. HERZOG

Copy received
November 11, 1974
Hoyngstman & Hoyngstman
Attys for Appellee

Copy received
November 11, 1974
Nathan Fogelson Esq.
Atty for Appellee